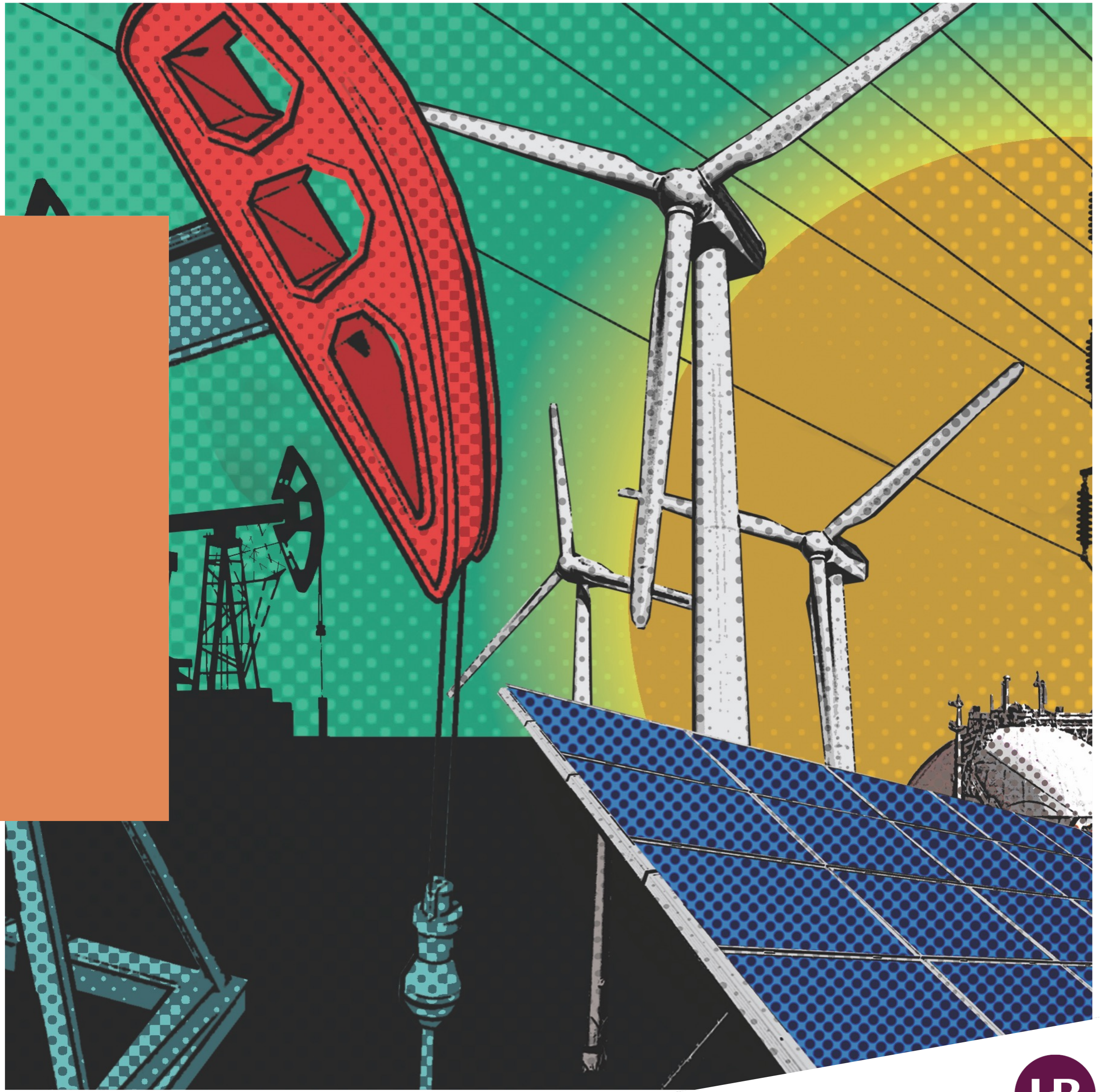
HAYNES BOONE

SEC Proposed Climate-Related Disclosure Rules



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Haynes and Boone, LLP

We are an **international corporate law firm** serving businesses around the world, including 20 percent of the Fortune 500.

Our **Corporate practice** includes more than 100 lawyers who primarily handle middle-market M&A and private equity deals, with exceptional capital markets and securities capabilities.

Our **Energy practice** lawyers advise clients on transactions, regulatory issues, disputes and restructurings across upstream, midstream and downstream oil and gas, plus power and renewables.

600+ LAWYERS

18 OFFICES

40 MAJOR LEGAL PRACTICE AREAS

Environmental, Social and Governance (ESG) Practice

Our lawyers are well equipped to help clients develop and implement a comprehensive approach to managing legal and business risks and addressing ESG related issues. We also assist investors and corporate boards in navigating how to implement ESG practices and the risks of not focusing on ESG matters. Haynes and Boone is committed to helping our clients achieve the highest standards of ethics, compliance and transparency in their ESG efforts.

We advise on ESG initiatives related to the following:

- ESG governance
- Public company disclosures
- ESG activism
- Environmental regulatory compliance
- Climate change
- Corporate governance
- Renewable energy
- Energy transition
- Human rights
- Community engagement
- Labor and employment
- Investor relations
- Cybersecurity
- Product governance
- Risk management
- Reputation/defamation protection
- Sustainable finance and green finance

In addition to advising on these policies, our firm lives by them. As an international law firm with offices around the world, Haynes and Boone is deeply committed to corporate social responsibility and sustainability. We understand these issues because we are facing them too, and we share our clients' and our communities' determination to embrace sustainable and socially engaged practices.

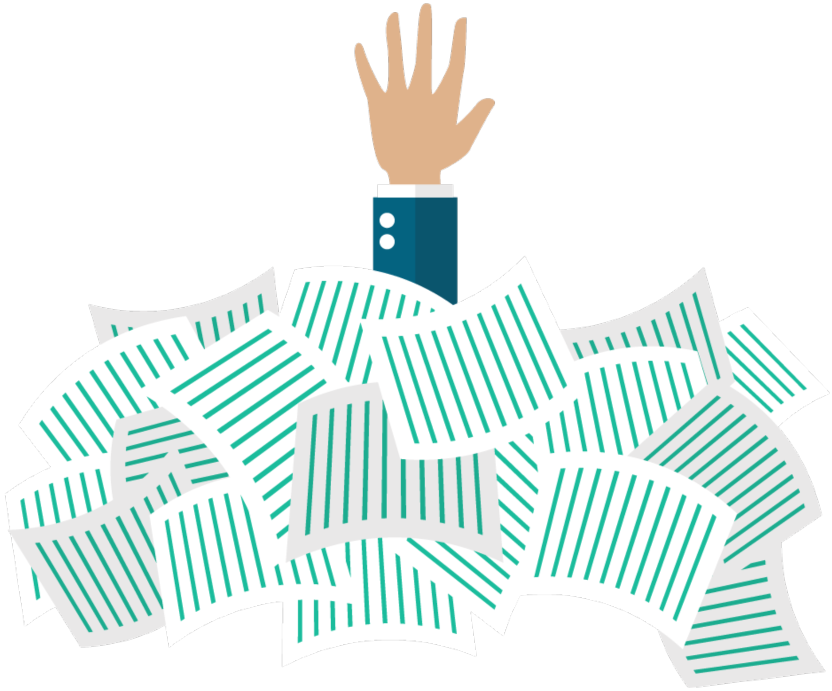
March 21, 2022: SEC Issues Proposed Rules for Climate-Related Disclosure

Overriding theme of the release: require disclosure of climate-related risks that is consistent, comparable and reliable (and therefore decision-useful)

If adopted,

- Public companies would generally be required to include specified disclosure in annual reports and registration statements (vs. websites and proxy statements)
- Required disclosure would be modeled in part on the TCFD framework and GHG Protocol

A Couple of Notes to Start



- 500+ page release: a lot to digest
- Limited accommodations for smaller public companies – the vast majority of the proposed rules would apply to all public companies, large and small
- It will be interesting to see what comment letters will be submitted to the SEC as well as whether the SEC's authority will be challenged

What Types of Qualitative Disclosures Would be Required?

- Climate-related risks and the material impacts on a company's business
- Governance of climate-related risks
- Risk management and strategies related to climate-related risks
- Transition plan, if a company has one
- Targets and goals, if a company has them

Note: if the company has a target or goal relating to Scope 3 emissions, then Scope 3 emissions must be disclosed.

What Types of <u>Quantitative</u> Disclosures Would be Required?

- Financial statement metrics on climate-related impacts, expenditures, estimates and assumptions (subject to internal control over financial reporting and audit)
- GHG Emissions
  - SEC notes disclosure of GHG emissions is important because they are <u>quantifiable</u> and <u>comparable</u> across industries and can be used to assess progress towards a net zero commitment as well as to help investors evaluate the transition risk faced by a company and its efforts to mitigate the risk
  - Not subject to internal control over financial reporting, but will be subject to disclosure controls
  - Attestation requirement for large accelerated and accelerated filers

What do the Proposed Rules Require for GHG Emissions?

Meth
ane

CO2

Sulfur
hexafl
uoride

Nitrous
Oxide

Trifluo
ride

Hydrofl
uoroca
rbons

Perflour
orocarb
ons

- Based on GHG Protocol (except with respect to methodologies)
- Disclosure proposed to be required:
  - Separately, the emissions for <u>each</u> of the 7 constituent greenhouse gases—*separately*, for each of Scope 1, Scope 2 (and, if required Scope 3) emissions
  - GHG intensity
  - Methodologies, significant inputs and significant assumptions
- GHG emissions must be reported on a "gross" basis without the effect of any offsets

When Would Scope 3 Emissions be Required to be Disclosed?

Scope 3 emissions would be required to be disclosed (1) if *material* OR (2) if a company has a target or goal that includes Scope 3 emissions.

- Scope 3 emissions: Indirect GHG emissions not otherwise included in a company's Scope 2 emissions which occur in the "upstream" and "downstream" activities of a company's "value chain"
- Required Disclosures: Identify the categories of upstream and downstream activities included in the calculation as well as the data sources and third-party data if material
- Challenges: Difficulties in obtaining necessary data from third parties; methodological uncertainties
- Limited accommodations for Scope 3: Safe harbor for Scope 3; SRC exemption and delayed compliance date

What if Our Company uses Carbon Offsets, RECs or an Internal Carbon Price?

- Carbon Offsets/RECs. Proposed rules would require disclosure of the role that carbons offsets or RECs play in the company's climate-related strategy (amount, source and cost)
- Internal Carbon Price. If used, disclose the price in units of the company's reporting currency per metric ton of CO2e and the total price, among other items

What To Do Now? A Few Questions to Consider as We Move Forward

- Should your company provide comments to the SEC on the proposed rules?
- How do the proposed disclosure requirements compare to the company’s current ESG tracking and disclosure?
- Are you tracking Scope 1 and Scope 2 emissions by each constituent greenhouse gas? What about Scope 3?
- Do you have climate-related targets or goals and are you ready to make the required disclosures?
- What kind of staffing might be needed to manage these disclosures?
- What changes to internal control over financial reporting as well as disclosure controls will be warranted?
- How much is this going to cost in terms of time and out-of-pocket expense?

Appendix

SEC Comments in Release Discussing Climate-Related Risks for Oil and Gas Companies

- "For example, an oil company might determine that a likely change in demand for fossil fuel-based products would require it to modify its business model or alter its product mix to emphasize advanced diesel gas and biofuels in order to maintain or increase its earning capacity, thereby requiring disclosure under the proposed rules."
- "An oil company might discuss a change in the valuation of its proven reserves because of an anticipated reduced demand for fossil fuels."
- "Registrants that are heavily reliant on water for their operations, such as registrants in the energy sector could face regulatory restrictions on water use, increased expenses related to the acquisition and purchase of alternative sources of water, or curtailment of its operations due to a reduced water supply that diminishes its earning capacity."

Commentary in the SEC Release Regarding Scope 3 and Oil and Gas Companies

- “For other industries, however, Scope 3 emissions represent a relatively significant portion of companies’ total GHG footprint, and therefore may reflect a more complete picture of companies’ exposure to transition risks than Scopes 1 and 2 emissions alone. For oil and gas product manufacturers, for example, Scope 3 emissions are likely to be material and thus necessary to an understanding of a registrant’s climate-related risks.”
- “For example, an energy company that produces oil and gas products may find that a significant category of activity resulting in Scope 3 emissions relates to the end use of its sold products.... In those cases, registrants would need to use their best judgment as to the description of the emissions source and provide sufficient transparency as to the reasoning and methodology to facilitate investor understanding of the emissions category and source.”
- The SEC noted that “the American Petroleum Institute has developed an overview of Scope 3 methodologies to inform oil and gas companies about Scope 3 estimation approaches.”

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